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Nigeria's Struggle with Corruption: The Success of Nigeria Extractive Industries Transparency Initiative

It is my pleasure to testify today on Nigeria's struggle with corruption. I have had the honor of advising Nigeria on the design, management and implementation of the audit they conducted in Nigeria's indigenous version of the Extractive Industries Transparency Initiative (NEITI). The NEITI process, launched in 2004, is the most comprehensive transparency program ever attempted under EITI auspices. Their efforts culminated last month in the publication of three audits that examined private sector and government participation in Nigeria's extractive industries from 1999-2004. It was a remarkable feat of political courage. Nigeria's leaders were keenly aware that the audits would reveal great weaknesses in government systems in a very public way yet they sought to make the audit as broad and deep as possible. The government and NEITI are now addressing the weaknesses in government oversight systems highlighted by the audit, evaluating how to implement the numerous reforms they recommended and addressing the discrepancies revealed by the audits. Today I will talk about what EITI is, what Nigeria's program aspires to accomplish, its progress to date and what US can and should do to help.

<u>What is EITI?</u>

In 2002 the UK Prime Minister, Tony Blair, announced the establishment of the Extractive Industries Transparency Initiative (EITI). This global initiative supports improved governance in resource rich countries through verifying and publishing company payments and government revenues from the oil, gas and mining sectors. The belief that underlies EITI is that the provision of information is a form of empowerment, and that implementing EITI will help to ensure that natural resource revenues contribute to sustainable development and poverty reduction.

Resource rich states have traditionally suffered from poor governance. The problem, called the resource curse or "paradox of plenty", is that governments that earn revenues from selling off natural resources are not accountable to their citizens because they do not need to tax them to run the government or the country. The non-oil sector atrophies. Governments tend to steal and squander monies they do have available. Governments employ anti-democratic methods to obtain and maintain power. By making revenues transparent, citizens can hold their governments accountable for natural resource wealth. A public understanding of government revenues and expenditures over time should encourage public debate and inform the selection of appropriate and realistic options for sustainable development.

EITI is a multi-stakeholder process. The theory is that all stakeholders have important and relevant contributions to make – including governments and their agencies, extractive industry companies, service companies, multilateral organizations, financial organizations, investors, and non-governmental organizations. EITI is not a cure all, but rather a minimum standard. EITI presupposes that a broadly consistent, simple and workable approach to the disclosure of payments and revenues is necessary and that it should involve all extractive industry companies operating in a country.

Structurally, EITI is made up of a coalition of governments, including France, Norway, the G8 and UK; companies, such as Anglo American, Barrick Gold, BG group, BHP Billiton, BP, Burren Energy, Chevron, Eni, ExxonMobil, Hess Corporation, Lonmin, Marathon, Newmont, Norsk Hydro, Repsol YPF, Rio Tinto, Shell, Statoil, Talisman Energy, TOTAL, Woodside, Xstrata; civil society groups, investors and international organizations including the European Bank of Reconstruction and Development, the International Monetary Fund, the World Bank Group, and the OECD. EITI is supported by an International Secretariat based in the UK's Department for International Development (DFID).

Since its inception, nearly 20 countries have endorsed EITI principles and criteria as delineated in the EITI source book, which can be obtained at http://www.eitransparency.org/keydocuments.htm. The EITI stakeholders are working to ensure that the EITI brand is meaningful. In 2005 the Initiative set out six criteria for countries implementing EITI. They are as follows:

1. *Regular publication of all material oil, gas and mining payments by companies to governments ("payments") and all material revenues received by governments from oil, gas and mining companies ("revenues") to a wide audience in a publicly accessible, comprehensive and comprehensible manner.*

2. *Where such audits do not already exist, payments and revenues are the subject of a credible, independent audit, applying international auditing standards.*

3. *Payments and revenues are reconciled by a credible, independent administrator, applying international auditing standards and with publication of the administrator's opinion regarding that reconciliation including discrepancies, should any be identified.*

4. *This approach is extended to all companies including state-owned enterprises.*

5. *Civil society is actively engaged as a participant in the design, monitoring and evaluation of this process and contributes towards public debate.*

6. *A public, financially sustainable work plan for all the above is developed by the host government, with assistance from the international financial institutions where required, including measurable targets, a timetable for implementation, and an assessment of potential capacity constraints.*

It takes time to get this kind of process off the ground. Countries go through six stages: sign up, set up, process development, disclosure and publication, public dissemination and discussion and review. Some countries are only beginning to launch the process; far fewer have published audits. Nigeria is essentially at stage six.

The goals of NEITI far exceed the criteria mandated by EITI. Nigeria has taken the transparency initiative to a new level by expanding the program to audit the physical flow of hydrocarbons and by taking a holistic approach to examining the energy sector, investigating government agencies in addition to private and state owned companies.

Nigeria’s EITI Program

Nigeria set its own, very ambitious course for EITI. The initial leadership came from President Obasanjo, who was a founding member of Transparency International before he was elected President, and Obiageli Ezekwisili, the Chairperson of NEITI, and now Minister for Solid Minerals and a former Finance Director of Transparency International. The EITI effort was part of a broader anticorruption campaign which included an intensive value for money review of government contracting and civil service reform, as well as the Economic and Financial Crimes Commission program. The President appointed a National Stakeholders Working Group (NSWG) comprised of 28 individuals with representatives from civil society, the media, government, indigenous and multinational companies, the organized private sector, the National Assembly, and the State’s (Regional) House of Assembly. The NSWG is the platform through which the NEITI is implemented.

NEITI set goals far beyond the basic EITI principles of revenue disclosure. Nigerians had little confidence in the integrity of any of the actors in the oil and gas value chain. It was essential to the NSWG to examine and audit the quantity of oil and gas lifted from well head to fiscalization, to track the money paid for the oil and gas from first sales to recordation in the Central Bank, to verify that all taxes and royalties and payments of any kind had been paid in full and deposited in the Central Bank, and to examine every major process from licensing to refining. The audits looked deep into the conduct and practices of the Central Bank of Nigeria (CBN), the Department of Petroleum Resources (DPR), the Nigerian National Petroleum Corporation (NNPC), the Federal Inland Revenue Service (FIRS) and many other government agencies. NEITI aims to institutionalize EITI principles and objectives by codifying them into law. NEITI seeks to build institutional capacity in the extractive industries, by modernizing its processes for acreage allocation, licensing, local content and information technology management. NEITI also strives to communicate the complex and comprehensive information it produces to all Nigerians, from diverse linguistic and socio-economic backgrounds, so that they are empowered to hold their governments accountable.

NEITI committed to conduct these audits under international accounting standards with a reputable external auditor. An international tender was conducted and the Hart Group of the UK was selected by the NSWG to conduct three highly comprehensive and intrusive audits: a financial audit, a physical audit and a process audit. The NSWG elected to audit the years 1999-2004, the duration of the Obasanjo administration at that time.

These audits set an unequalled precedent for other resource rich countries. Nigeria was the first to insist that all such revenues be published in a disaggregated fashion – company by company, category by category and well by well. All of the results, including interim reports, were posted on the web at www.NEITI,org. Nigeria was the first government to look intrusively at its own entities, not just at the conduct of private companies. It was the first, and still the only country, to look at physical systems and business processes as well as financial flows.

NEITI’s ability to achieve this success and future successes is in large part due to the constant support of President Obasanjo. Implementation was not always easy and compliance lagged. In the end there was tremendous cooperation on the part of all parties. Enormous amounts of information have been generated, audited and now published on the web. But at multiple points the President issued orders to cooperate or sat down with the entities covered by the audit –public and private – to forge cooperation.

Results of the Audit

The financial audits summarize, analyze, and confirm the financial flows between the federal government and the oil and gas industry from 1999 to 2004. Net inflows from the sector to the Federation Account at the Central Bank, taking Nigerian payments to joint-ventures into account, amounted to US$6 billion in 1999, US$14 billion in 2000, $15 billion in 2001, $8 billion in 2002, $12 billion in 2003, and $24 billion in 2004. The cash flows include sales of crude oil, petroleum profits taxes (PPT), royalties, gas flare penalties, general non-oil specific flows (VAT, withholding tax), and payments to the Niger Delta Development Corporation (NDDC). All transactions involve the Nigerian Central Bank (CBN) and two regulatory agencies, the Federal Internal Revenue Service (FIRS) and the Department for Petroleum Services (DPS), and the audit compared the records of the oil and gas companies with records from all three government bodies.

The discrepancies between the CBN's and the companies' reported payments were less than 2% of financial flows, but still significant, reaching a net $230 million in 2002. The Financial Audit reveals that accounting, timing, and classification differences account for some, but not all of these discrepancies. One significant difference is that the government uses the cash basis of accounting while company accounting is done on an accrual basis. The audit encountered several difficulties stemming from the inadequacy of systems at government level, including the absence of independent records by the Accountant General of the Federation (AGF), the failure of the CBN to maintain complete records, the failure of the FIRS to effectively audit the accounts of state owned or private companies, and the failure for the DPR to regulate the calculation and payment of royalties by companies operating in the sector.

To remedy these shortcomings, the Hart Group recommends reforms that place the AGF in a position of management and control over the Federation account. To accomplish this, the information system of recording and reporting revenues and production levels requires overhaul so that the AGF can directly monitor money received by the CBN.

The NEITI Physical Audit is based on hydrocarbon net volume balances provided by companies. The data is questionable, however, as it is based on how much oil reached export terminals, rather than how much was originally pumped from oilfields. A mass hydrocarbon volume balance could not be calculated because the DPR does not require that mass volumes be recorded and reported, and operating companies do not record, and in some cases have failed to report, these volumes. This is problematic because it is not possible to calculate the amount of crude oil stolen along the supply chain. Oil industry estimates of the amount of oil Nigeria loses to crude theft vary widely, but "bunkering" is undoubtedly a significant problem.

The audit recommends that in the short term reconciliation of export liftings between DPR and companies should take place regularly to identify inconsistencies on a timely basis. In the long term the NSWG, federal government, and companies need to open a dialogue to improve and expand metering infrastructure, ultimately providing more accurate data along the flow stream. The audit also recommends that DPR create a standard for measuring royalties, which have been calculated at various points along the flow stream, to ensure consistent calculations of amounts owed to the Federation. Standardizing definitions of the hydrocarbon mass balance across the industry will ensure that all companies pay royalties and PPT at the same point in the flow stream.

The NEITI Process Audit examined multiple aspects of the process by which oil and gas industry operates, including refining and importation, capital and operating expenditure, marketing crude, licensing, and marketing natural gas. The report on refineries cited significant discrepancies between the crude oil lifted from terminals and the crude received at refineries, in the amount of 200,000 tonnes. Nigerian refineries were also found to be inefficient (41% capacity) compared to the rest of the world (85% average capacity) due to poor management processes.

With regard to licensing, the Hart Group recommends that Nigeria tighten its pre-qualification criteria for companies licensed to import oil products to avoid the potential for licensing to unsuitable companies. They also cite the need for greater transparency in the bidding process through improvements in the quality and quantity of publicly available data. The Process Audit on the marketing of natural gas cited major impediments to the development of the sector, including the absence of a regulator for the sector, the non-payment of gas bills by parastatals, and subsidized pricing. The audit also indicated that there was no clear marketing strategy for gas, and that the approach thus far was largely politicized.

In sum, the NEITI Financial, Physical, and Process audits succeeded in identifying numerous problem areas where sector management is not transparent and where reform is required to deter corruption and mismanagement. The audits represent a significant step towards greater transparency in Nigeria's oil and gas sector.

Next Steps

The key test for Nigeria will be what comes next. The relevant stakeholders must now ensure that the information garnered by the audits is effectively used to improve the sector. The three audits have been posted on the NEITI website, www.neiti.org but the key findings must be simplified and communicated effectively across the country. On May 3, 2006, President Obasanjo endorsed the recommendations of the auditors presented to him by NEITI and authorized NEITI to develop a work plan to implement them. He expressed his commitment to comprehensively respond to the Audits' findings through initiatives that will repair the relevant systems to avoid future failures and opportunities for corruption and to prosecute any clearly identified case of wrongdoing. NEITI is devising a work plan to implement these recommendations.

The most immediate steps will be to clarify remaining discrepancies, institutionalize NEITI by codifying it into law, communicating the results of the audit, adopting a reform agenda, modernizing relevant government agencies, and conducting the 2005 audit. Some detailed explanation of these next steps will illuminate the magnitude of the task Nigeria faces.

Resolving Discrepancies. Further work is needed to reconcile financial discrepancies between the CBN and the companies as well as nonconformities between the DPR and company assessments of oil production and export value. Discrepancies in volumetric data for hydrocarbon streams also need to be re-examined. The President has directed the Hart Group to update progress on these issues by mid-June.

Improving Regulatory Capacity. The auditors essentially recommend that the DPR assert more authority in the collection and regular monitoring of royalties, and that the DPR spearhead arrangements for monitoring the entire hydrocarbons balance. The DPR is also tasked with establishing guidelines for the preparation of mass balance statements, which oil companies should be required to complete annually. The auditors further recommend that the FIRS improve record keeping and the assessment of PPT. Finally, external auditors should be required to report annually on the hydrocarbon mass balance.

Institutionalizing NEITI. The NEITI bill has been passed by the National Assembly and is expected to be passed by the Senate. The bill is designed to develop a permanent framework for transparency in the reporting and disclosure of revenues accrued by companies or paid to the government, to require the companies to maintain accurate records of costs and sales of petroleum; and to ensure annual audits of the sector. Once it is passed, NEITI will require a fresh appropriation for its audit work, as well as funding for communications work and additional analytical work.

Communicating Results. The results of the audit need to be communicated to the Nigerian public. Disclosure and publication will enable Nigerians to hold their government accountable for the management of revenues; ensure a level playing field amongst producing companies; bring about improved corporate governance and improve energy security. The goal of the initiative was to help eliminate the opaqueness of energy sector transactions to ease the social divisiveness and instability which has led to disruption of production in the Niger Delta. This will require a sophisticated effort, requiring translation into five languages, using television, newspaper, radio and billboards and requiring road shows to travel into remote parts of the country to explain the audit work and the reform agenda. If done correctly it will be a mammoth undertaking.

Adopting a Reform Agenda. Engagement of the Nigerian public is intended to compel the government to adopt a reform agenda. The roles and strengths of relevant agencies need to be re-evaluated. The DPR needs to play a greater role in assessing royalties, the AFG needs greater management and control capacity, the FIRS' capacity to deal with PPT should be strengthened. These are each major, multiyear capacity building efforts. Some help in these areas could be outsourced, but it would require major funding to do so. The government will need to balance what is most critical with what can be done promptly and what it can afford.

Modernizing IT Systems. A necessary component of strengthening government capacity is modernization of the way it does its business. Nigeria needs a major business process reengineering effort. To ensure proper computation, assessment, and calculation of royalties, DPR should implement a robust accounting system and IT infrastructure comparable to those used by the producing companies. To ensure that companies pay tax liabilities on time, FIRS needs to adopt best practices for their record keeping and accounting system. To facilitate the accessibility of detailed information on lifting and payments, the Crude Oil Marketing Department (COMD) needs to adopt a double entry bookkeeping system and maintain a record of accounts receivable. Standardizing definitions and clarifying critical practices that require common understandings between entities will also serve to regularize the sector. Each one of these systems reforms can be a major financial undertaking; creating a system that multiple government agencies can use is both indispensable to better governance and formidably expensive.

How the U.S. Can Help

The United States has been an observer, but not a supporter of EITI in general or the NEITI effort in particular. The US did endorse EITI at the Evian and Sea Isle G-8 Summits, and it attends the EITI International Advisory Group meetings. But EITI is rarely raised at the Head of State or Secretary of State level. The US does not contribute to the World Bank Trust Fund for implementation of this initiative or provide bilateral support for it. The US rightly believes that expenditure transparency is as important as revenue transparency. This is indisputably true. But EITI is a first step and a fundamental one.

To date, most of the support for NEITI has come from the UK's DFID and some from the World Bank. The DFID has committed $4.2 million to the World Bank EITI Trust Fund so far, of which $2.6 million has been earmarked for NEITI. The sum of $2,814,000 has been disbursed to date, largely in form of a Development Grant.

Achieving Nigeria's ambitious goals will require overcoming enormous obstacles. The technical needs are huge: regulators need to be trained, IT systems need to be designed and implemented, funds need to be raised for deploying the communication strategy, and agencies need to be provided with basic support.

There is a great opportunity for the US to contribute to NEITI in the months and years ahead. The US should acknowledge the accomplishments of NEITI at the highest level to publicly demonstrate US support for Nigeria's effort and to reinforce their positive improvements.

Financial support should be made through the World Bank Trust Fund and bilateral assistance programs. Congress appropriated $1 million last year to support EITI in resource-rich developing countries through US bilateral programs and directly to civil society. This amount should be increased significantly and should be focused on implementation issues where the US has strong expertise, such as public diplomacy, oil and gas regulation, and information technology systems.

Nigeria has taken an enormous step forward in creating transparency and empowering the public to fight corruption. Courageous work such as this should be encouraged and supported. As a nation we are quick to criticize corruption and condemn governments that tolerate it. We must be as quick to lend a helping hand to those who have taken up the fight, but need the weapons to prevail.